Journal of Business & Technology Law

Volume 4 | Issue 2 Article 1

The Subprime Meltdown: Causes, Consequences, and Solutions

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FOREWORD

THE GLOBAL ECONOMIC DOWNTURN gripping both the United States and the rest of the world has been likened to some of the country's greatest financial crises.[1] Allusions have been made suggesting that the crisis may even be worse than the Great Depression.[2] The failure of banks,[3] the increase in mortgage foreclosure rates,[4] the decrease in gross domestic product,[5] and the myriad other challenges are merely symptoms of a larger financial problem.[6]

Many theories abound for the cause of this crisis.[7] Blame has been placed on Presidents,[8] CEOs,[9] stock traders,[10] oil companies,[11] consumers,[12] mortgage borrow-

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* Due to the contentious nature of the debate surrounding the subprime meltdown, the *Journal* editors have strived to publish several different perspectives in this issue. The views expressed by the authors in this issue do not necessarily represent the views of the editorial board of the *Journal of Business & Technology Law*.

1. *See* Jon Hilsenrath, *Worst Crisis Since '30s, With No End Yet in Sight*, WALL ST. J., Sept. 18, 2008, at A1 ("This has been the worst financial crisis since the Great Depression. There is no question about it.").

2. *Id.*

3. *See* Colin Barr, *Washington Plans for Big Bank Failure*, FORTUNE, Mar. 6, 2009, http://money.cnn.com/2009/03/06/news/dodd.fdic.fortune/index.htm; *First Bank Failures of '09*, CNNMONEY.COM, Jan. 16, 2009, http://money.cnn.com/2009/01/16/news/economy/bank_failure/index.htm.

4. Katherine Porter, *Misbehavior and Mistakes in Bankruptcy Mortgage Claims*, 87 TEX. L. REV. 121, 128 (2008) ("Spiking foreclosure rates and pressure from Wall Street may exacerbate problems with mortgage servicing. Falling real-estate prices have changed the profit calculus of foreclosure, encouraging lenders to reach out to delinquent borrowers.").

5. Catherine Rampell, *G.D.P. Revision Suggests Long, Steeper Downturn*, N.Y. TIMES, Feb. 28, 2009, at B3. The U.S. gross domestic product fell at an annualized rate of 6.2% in the fourth quarter of 2008, the sharpest decline since the 1982 recession. *Id.*

6. *See, e.g.*, Nelson Schwartz et al., *Unemployment Surges Around the World*, N.Y. TIMES, Feb. 15, 2009, at A1 (the global economic downturn has caused high unemployment rates in the U.S. and around the world, causing protests and strikes). According to Dennis C. Blair, the newly appointed United States Director of National Intelligence, "the instability caused by the global economic crisis ha[s] become the biggest security threat facing the United States, outpacing terrorism." *Id.*

7. Damon Silvers & Heather Slavkin, *The Legacy of Deregulation and the Financial Crisis—Linkages Between Deregulation and Labor Markets, Housing Finance Markets, and the Broader Financial Markets*, 4 J. BUS. & TECH. L. 301, 302 (2009).

8. *See* Jackie Calmes, *In Washington, Financial Furor is a First-Rate Chance to Assess Blame*, N.Y. TIMES, Sept. 18, 2008, at C10 (noting that House Speaker Nancy Pelosi placed the blame for the financial crisis on the Bush administration because of their "'inattention or a decision on their part to have crony capitalism in our country'"); Terry Jones, *Congress Lies Low to Avoid Bailout Blame*, INVESTOR'S BUS. DAILY, Sept. 18, 2008, http://www.ibdeditorials.com/IBDArticles.aspx?id=306632135350949; Time, *25 People to Blame for the Financial Cri-*

ers,[13] and many others.[14] Some have claimed that this situation was unforeseeable,[15] while others have argued it was inevitable.[16]

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ses, http://www.time.com/time/specials/packages/article/0,28804,1877351_1878509,00.html (last visited Mar. 23, 2009) (naming Bill Clinton as one of the people to blame for the subprime meltdown).

9. *See* Time, *supra* note 8. Time Magazine deemed Angelo Mozilo, the former CEO of Countrywide Financial, the most culpable for America's financial meltdown for making mortgage loans available to virtually any borrower. *Id.* Former American International Group executive Joe Cassano made the list at No. 7 for recklessly betting billions of dollars on the continued rise in housing prices by selling credit default swaps (CDS) that insured questionable mortgage-backed securities. *Id.* Making the list at No. 8 was Ian McCarthy, CEO of Beazer Homes, for building more homes than the country could stomach. *Id.* Frank Raines, the former CEO of Fannie Mae, was ranked 9th for easing the credit requirements on loans that Fannie Mae purchased from banks in 1999. *Id.* Former CEO of Lehman Brothers, Dick Fuld, made the list at No. 11 for investing heavily in subprime mortgages and driving the fourth-largest U.S. investment bank into bankruptcy. *Id.* Marion and Herb Sandler, the co-CEOs of Golden West Financial, made the list at No. 12 for first selling adjustable-rate mortgages. *Id.* At No. 15 was former Merrill Lynch CEO Stan O'Neal for amassing $41 billion in subprime collateralized debt obligations and mortgage bonds. *Id.* Rounding off the list in the 25th spot was Jimmy Cayne, former CEO of Bear Stearns for holding nearly $40 billion in mortgage bonds that were essentially worthless. *Id.*

10. *Id.*

11. *See generally* Fritz Rhyner, *Letters: Plenty to Blame for Financial Crisis*, THE NORTHWESTERN, Mar. 8, 2009, at 1, *available at* http://www.thenorthwestern.com/article/20090308/OSH0603/903080399/1189/OSH06 (explaining that there are a multitude of possible culprits for the financial crisis including oil producing countries in conjunction with oil companies raising the price of oil).

12. *See* Time, *supra* note 8 (ranking American consumers as among those to blame for the financial crisis for trying to live beyond their means by borrowing too much money on credit).

13. *Id.*

14. *See* Calmes, *supra* note 8 (relating that Senator John McCain faulted federal regulators); *see also* Time, *supra* note 8. Time Magazine's list for the top 25 people to blame for the financial meltdown included GOP Senator Phil Gramm who played a leading role in pushing through Congress the Gramm-Leach-Bliley Act in 1999, which dismantled the Glass-Steagall Act that separated commercial banks from investment banks; former Federal Reserve Chairman Alan Greenspan for presuming that financial firms would regulate themselves; ex-chairman of the Securities and Exchange Commission Chris Cox for failing to regulate investment banks; Treasury Secretary Hank Paulson for eroding investor confidence by letting Lehman Brothers fail and spending funds from the Troubled Assets Relief Program ineffectively; Kathleen Corbet, former President of Standard & Poor's, for assigning AAA ratings, the highest possible rating, for CDOs that are now unsellable; Wen Jiabao, the moneyman for the Chinese government, for supplying the U.S. government with tons of cheap credit; David Lereah, the former Chief Economist at the National Association of Realtors, for frequently forecasting increases in home prices; and Burton Jablin, the senior vice president of programming at HGTV—Home & Garden Television—for helping inflate the real estate bubble by teaching viewers how to extract value from their homes. *Id.*

15. Alan Greenspan stated that "the essential problem is that our models—both risk models and econometric models—as complex as they have become, are still too simple to capture the full array of governing variables that drive global economic reality." Colin Barr, *The Questions Greenspan Didn't Ask*, CNNMONEY.COM, Apr. 11, 2008, http://money.cnn.com/2008/04/10/news/newsmakersgreenspan.fortune/.

16. *See* Stephanie Baker, *Taleb's 'Black Swan' Investors Post Gains as Markets Take Dive*, BLOOMBERG, Oct. 14, 2008, http://www.bloomberg.com/apps/news?pid=20601087&sid=aDVgqxiT9RSg&refer=home (noting that Nassim Taleb predicted the banking crisis in his 2007 novel *The Black Swan: The Impact of the Highly Improbable*). The subprime mortgage meltdown may have been foreseeable due to some very telling clues. Prem Watsa, CEO of Fairfax Financial Holdings, Inc., raised concerns in 2003 about the risks in "asset-backed bonds, particularly bonds that are backed by home equity loans, automobile loans or credit card debt" because securitization seems to eliminate "the incentive for the originator of the loan to be credit sensitive." Michael Watkins, *Suprime: A Predictable Surprise*, BUSINESSWEEK, Dec. 17, 2007, http://www.businessweek.com/managing/content/dec2007/ca20071213_764745.htm.

With this in mind, the University of Maryland School of Law's Business Law Program and the *Journal of Business & Technology Law* used the School's Seventh Annual Business Law Conference to address the present economic situation. Specifically, Conference participants were asked to examine *The Subprime Meltdown: Causes, Consequences, and Solutions*. On October 3, 2008, panelists and attendees convened to look at this important aspect of the financial crisis.

Panelists focused on the subprime meltdown from not only an academic vantage point,[17] but also from the perspective of private law practice, investment,[18] government,[19] consumer protection,[20] labor,[21] and the media.[22] Overshadowing the entire day was the congressional discussion of the Emergency Economic Stabilization Act of 2008[23] and the Troubled Asset Relief Program,[24] which passed as the Conference occurred.[25]

Included in this issue of the *Journal* are pieces from some of the Conference participants. As the financial crisis continues, these perspectives offer context of how we arrived at this point, and also what can be done to fix the problem. We thank all of the authors in this issue as well as the Conference panelists for adding to the discourse on this vitally important topic.

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17. Lisa M. Fairfax, Professor of Law and Director of the Business Law Program at the University of Maryland School of Law; José M. Gabilondo, Associate Professor of Law at the College of Law Florida International University; Michael Greenberger, Professor of Law and Director of the Center for Health and Homeland Security at the University of Maryland School of Law; Claire Hill, Professor of Law and Associate Director of the Institute for Law and Economics at the University of Minnesota Law School; Christine Hurt, Co-Director of the Program in Business Law and Policy at the University of Illinois College of Law; David Reiss, Associate Professor of Law at Brooklyn Law School; and Karen H. Rothenberg, Dean and Marjorie Cook Professor of Law at the University of Maryland School of Law.

18. Mark Cicirelli, Investment Analyst at Elliot Associates, LP.

19. Thomas E. Pérez, Secretary of Maryland Department of Labor, Licensing and Regulation; Kathleen C. Ryan, Counsel for Division of Consumer and Community Affairs at the Federal Reserve Board; David Smith, Chief Economist of U.S. House Committee on Financial Services; and Ralph S. Tyler, Commissioner of the Maryland Insurance Administration.

20. Ira Rheingold, Executive Director and General Counsel for the National Association of Consumer Advocates.

21. Damon Silvers, Associate General Counsel for AFL-CIO; and Heather L. Slavkin, Senior Legal and Policy Advisor for AFL-CIO Office of Investment.

22. Teresa Tritch, Member of the New York Times Editorial Board.

23. Pub. L. No. 110-343, 122 Stat. 3765.

24. The Emergency Economic Stabilization Act of 2008 was enacted with the primary objective of establishing the Troubled Asset Relief Program, which confers broad authority on the Secretary of Treasury to purchase troubled assets. Pub. L. No. 110-343, § 101, 122 Stat. 3765, 3767 ("The Secretary is authorized to establish the Troubled Asset Relief Program (or 'TARP') to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act . . . .").

25. The U.S. Senate voted on H.R. 1424 (Emergency Economic Stabilization Act of 2008) on Wednesday, October 1, 2008. U.S. Senate Roll Call Votes 100th Congress—2nd Session, http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=110&session=2&vote=00212 (last visited Mar. 24, 2009). The U.S. House of Representatives voted on H.R. 1424 on Friday, October 3, 2008. Final Vote Results for Roll Call 681, http://clerk.house.gov/evs/2008/roll681.xml (last visited Mar. 24, 2009). President Bush signed H.R. 1424 into law on the same day. Alex Johnson, *Bush Signs $700 Billion Financial Bailout Bill*, MSNBC.COM, Oct. 3, 2008, http://www.msnbc.msn.com/id/26987291/from/RSS/%22.